IN THE

Supreme Court of the United States

OCTOBER TERM 1968

No. 42

Office-Supreme Court,
FILED
FEB 26 1969
JOHN F. DAVIS, CLERK

HOWARD BOSS and BERNARD BOSS, as Trustees for LENA ROSENBAUM,

Petitioners,

—against—

ROBERT A. BERNHARD, *et al.*,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

RESPONDENTS' BRIEF IN OPPOSITION

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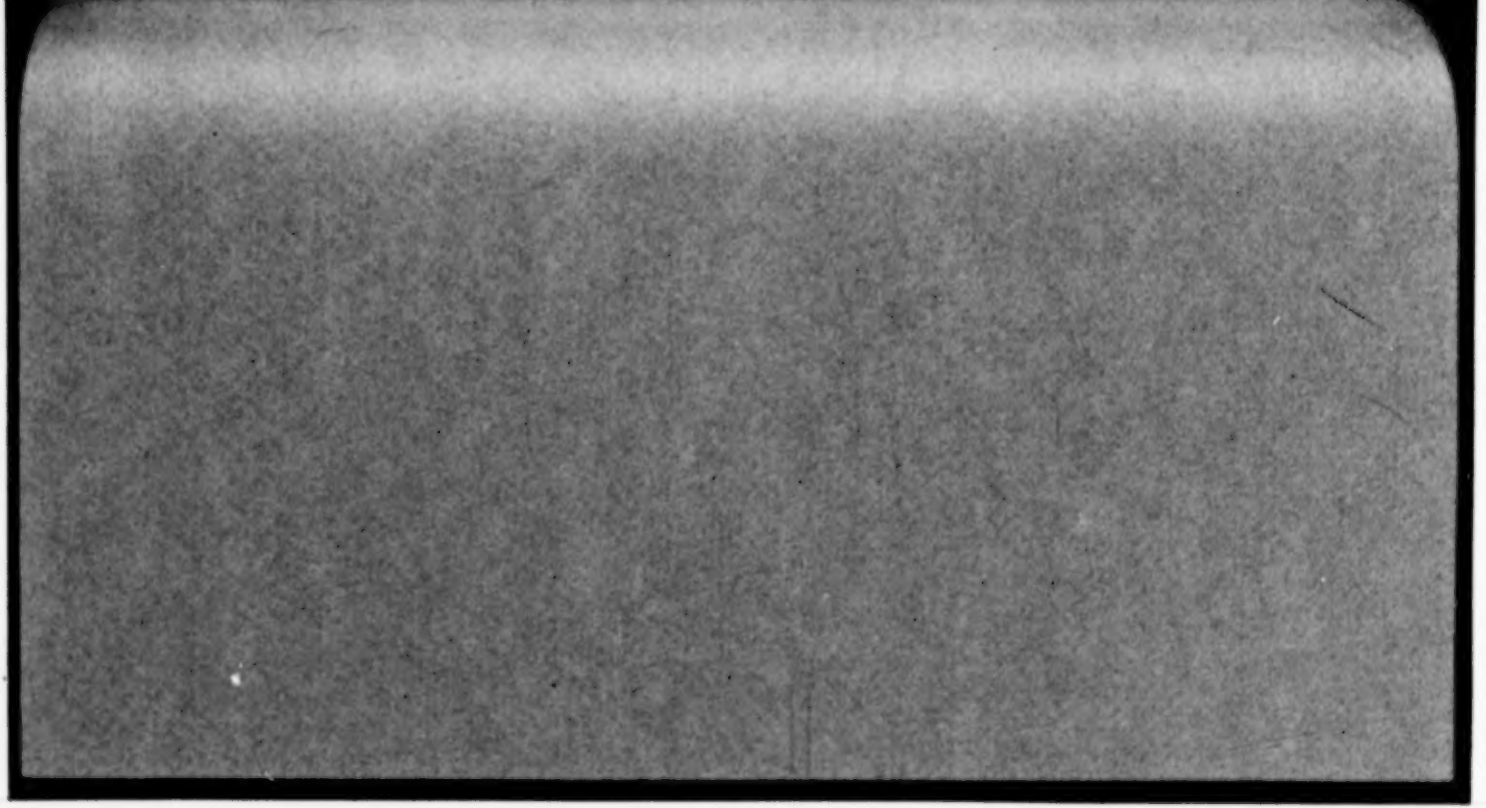
February 25, 1969



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October Term 1968

HOWARD ROSS and BERNARD ROSS, as Trustees for LENA ROSENBAUM,
Petitioners,
—against—
ROBERT A. BERNHARD, *et al.*,
Respondents.

No. 992

RESPONDENTS' BRIEF IN OPPOSITION

The Question Presented

Irrespective of the nature of the claim asserted on behalf of the corporation, does the plaintiff in a stockholder's derivative suit have a personal constitutional right to trial by jury of the claim he asserts on behalf of the corporation?

Reasons for Denial of the Writ

I.

Not every conflict among the circuits requires resolution by this Court and this is just such a case. The decision which petitioners challenge was clearly correct in its statement and application of the controlling constitutional standard: Was there a right to jury trial in a stockholder's derivative suit at common law at the time of the adoption of the Seventh Amendment in 1791 or, indeed, at any subsequent time? *Parsons* v. *Bedford,* 28 U.S. (3 Pet.) 433

(1830); *Dimick* v. *Schiedt*, 293 U.S. 474, 476 (1935); *Baltimore & C. Line* v. *Redman*, 295 U.S. 654, 660 (1935).

A litigant's right to trial by jury under the Seventh Amendment is thus to be determined by history and by history alone. If there was no right to trial by jury in such a case at common law, there is no right to jury trial preserved by the Seventh Amendment. The petition acknowledges by its complete silence on the point that the stockholder's derivative suit is and always has been a creature of equity. It follows that there is no jury right which the Seventh Amendment could preserve. *Koster* v. *Lumberman's Mutual Co.*, 330 U.S. 518, 522 (1946); *Attorney-General* v. *The Governors of the Foundling Hospital*, 2 Ves. Jun. 42 (1793); *Attorney-General* v. *Utica Insurance Co.*, 2 Johns. Ch. 371 (N.Y. 1817); *Brinckerhoff* v. *Bostwick*, 105 N.Y. 567 (1887); *Bookbinder* v. *Chase National Bank*, 244 App. Div. 650 (1st Dep't 1935); *Rebstock* v. *Lutz*, 158 A.2d 487 (Del. 1960); *Rosenthal* v. *Burry Biscuit Corp.*, 60 A.2d 106 (Del. Ch. 1948); 4 *Pomeroy, Equity Jurisprudence*, § 1095 (5th ed. 1941); Prunty, *The Shareholders' Derivative Suit: Notes On Its Derivation*, 32 N.Y.U.L. Rev. 980 (1957); Note, *The Right to a Jury Trial in a Stockholder's Derivative Action*, 74 Yale L.J. 725 (1965).*

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* With the single exception of *DePinto* v. *Provident Security Life Ins. Co.*, 323 F.2d 826 (9th Cir. 1963) *cert. denied*, 376 U.S. 950 (1964), *reh. denied* 383 U.S. 973 (1966), our research does not indicate that any stockholder's derivative suit in this country or in England has ever been tried to a jury. Certainly no such suit has ever been tried to a jury in the Southern District of New York, which probably entertains a far greater number of such suits than any other district. Contrary to petitioners' insinuation (Pet., p. 10fn), no derivative claim was tried to a jury in *Richland* v. *Crandall*, 259 F. Supp. 274 (S.D.N.Y. 1966), where after the court determined that derivative claims were not triable to a jury, representative class claims were tried to a jury and derivative claims were later determined by the court.

Moreover, prior to the merger of law and equity effected in 1938 by the Federal Rules of Civil Procedure, stockholders' derivative suits could be brought only on the equity side of the federal courts. It was apparently not until 1855 that the first stockholder's derivative suit came to this Court and on that occasion this Court stressed that the "stockholder's bill" was an invention of equity for "prosecution of injuries for which common-law courts were inadequate" *Dodge v. Woolsey*, 59 U.S. (18 How.) 331, 341 (1855). The equitable remedy which this Court approved in *Dodge v. Woolsey* soon became the subject of abuse as corporations procured stockholders to bring derivative suits to take advantage of diversity jurisdiction that might not otherwise be available. In *Hawes v. Oakland*, 104 U.S. 450 (1881), the Court attempted to curb such abuses by holding that a stockholder could not sue on behalf of the corporation unless he held his stock at the time of the wrong complained of and unless the corporation refused, despite honest efforts by the stockholder, to bring the action on its own behalf. The precaution devised in *Hawes* v. *Oakland* was almost simultaneously promulgated as Equity Rule 94 (104 U.S. ix). That rule, with only minor revision, became Equity Rule 27 in 1913 (226 U.S. 629, 656) and later the original Rule 23 (now Rule 23.1) of the Federal Rules of Civil Procedure.

In providing in Rule 38 of the Federal Rules of Civil Procedure that the right to trial by jury "shall be *preserved* to the parties inviolate" [emphasis added], certainly this Court did not intend to confer jury rights in a type of case which previously could be brought only in equity and which was specifically provided for in the Equity Rules.

II.

Ignoring completely the controlling historical test, petitioners rest upon an ingenious twist of this Court's admonition in *Dairy Queen, Inc.* v. *Wood*, 369 U.S. 469, 470-472 (1962) that the merger of law and equity was not intended to deprive litigants of their constitutional right to trial by jury of legal issues. Petitioners' theory is that the stockholder asserts two separate claims in a derivative suit—an equitable claim against the corporation for failure to bring suit against the alleged wrongdoers and a legal claim on behalf of the corporation —, that it was only equity's jurisdiction over the first claim which gave it jurisdiction over the second and that now, with the merger of law and equity in the federal courts, both can be tried together, one to a jury and the other to the court. The flaw in petitioners' theory is that the two elements of a derivative suit are not and never were separate or divisible; the stockholder plaintiff cannot recover unless he prevails on both. Neither as a matter of historical development or common sense could it be said that the claim asserted on behalf of the corporation is "incidental" to the equitable claim against the corporation for its refusal to sue.

Moreover, as this Court observed in *Dairy Queen, Id.* at 470-471, a federal court of equity, prior to the promulgation of the Federal Rules of Civil Procedure in 1938, could not even take jurisdiction of a suit in which legal and equitable claims were joined. *Scott* v. *Neely*, 140 U.S. 106 (1891); *Cates v. Allen*, 149 U.S. 451 (1893). In consistently recognizing between 1855 and 1938 that stockholders' derivative suits were maintainable in the federal equity courts, this Court necessarily rejected the notion that for the purpose of determining rights to jury trial, the derivative suit consisted of separable legal and equitable claims.

III.

The "Question Presented" by the petition assumes incorrectly that the claims which petitioners assert on behalf of the corporation are legal in nature, so that if asserted by the corporation, both the corporation and the defendants could demand a jury. Apart from the fact that it is only the plaintiff shareholders here who seek a jury, the Court of Appeals did not reach the question whether the claims asserted by petitioners on behalf of the corporation were legal in nature.

Petitioners' second amended complaint belies on its face the petition's characterization of petitioners' claims as sounding in "negligence" (Pet., p. 11). Instead, the second amended complaint clearly and unequivocably accuses the defendants of fraud and overreaching, of wilful and deliberate breaches of duties which are alleged to be "fiduciary" (pars. 15, 17, 21, 22). The word "negligence" appears only once in a single paragraph of the second amended complaint as part of the phrase "gross negligence" and even that phrase appears only as one of a string of epithets which are hardly consistent with mere negligence.*

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* Paragraph 21 of the second amended complaint reads as follows:

"21. The payment of these brokerage commissions to Lehman Brothers and others has constituted and continues to constitute an unlawful and willful conversion by Lehman Brothers and the individual defendants of the monies, funds, property and assets of the Corporation to the use of Lehman Brothers in violation of Sec. 37 of the Act; and gross abuse of trust, gross misconduct, willful misfeasance, bad faith, gross negligence and a reckless disregard of their fiduciary duties by the Corporation's officers, directors and brokers in violation of the duties which the Act (Secs. 1(b)(2), 10, 17(h) and (i) and 36) expressly and by necessary implication imposes upon officers, directors and brokers of investment companies."

There would be no right to trial by jury even if petitioners' epithets were hurled by the corporation, for traditionally it was only in equity rather than through the writs of the common law that redress was available for misuse of corporate office. *Robinson* v. *Smith,* 3 Paige Ch. 221 (N.Y. 1832); *Attorney-General* v. *The Governors of the Foundling Hospital,* 2 Ves. Jun. 42 (1793); and *Adley* v. *Whitstable Co.,* 17 Ves. Jun. 315 (1810).

The amended complaint alleges that over a period of five years, Lehman Brothers received approximately $2,000,000 in brokerage commissions from the corporation (A. 19). Manifestly, there were in those five years many thousands of separate portfolio transactions aggregating scores of millions of dollars. Alleging that some of these thousands of transactions were improperly executed at excessive cost to the corporation, petitioners seek an accounting for defendants' "profits".

Since petitioners allege one species of breach of trust in connection with transactions in listed securities and quite another in connection with transactions in unlisted securities, the task confronting the trier of fact will be to examine the two types of transactions separately. The trier of fact may be required to cull from many thousands of transactions in listed securities those which petitioners claim could have been executed off the Exchange in the so-called "third market" and to determine with respect to each such transaction whether the "third market" offered advantages to the corporation which the defendants unlawfully forsook. With respect to over-the-counter transactions, the trier of fact may be required to determine with respect to each whether Lehman Brothers was unnecessarily "interposed", and if so, whether the cor-

poration was damaged and in what amount. And if any transactions, whether in listed or in unlisted securities, are found to have been unlawful, the trier of fact may be required to determine as to each the extent to which defendants profited unlawfully. Thus, each of many thousands of transactions may require a precise and obviously difficult measurement of claimed disadvantage to the corporation.

It would be a perversion of history to suggest that the dissatisfaction with the Constitution as first presented to the states for adoption and which gave rise to the first ten amendments was rooted in any conviction that cases of such complexity should be tried by veniremen of the community. The contemporaneous literature demonstrates to the contrary that the Seventh Amendment was intended to preserve the traditional role of the Chancellor in deciding—without the intervention of a jury—those "nice and intricate" issues which "are incompatible with the genius of trials by jury". As Hamilton pointed out in *The Federalist* while the first ten amendments were being considered by the states:

> ". . . the circumstances that constitute cases proper for courts of equity, are in many instances so nice and intricate, that they are incompatible with the genius of trials by jury. They require often such long and critical investigation, as would be impracticable to men called occasionally from their occupations, and obliged to decide before they were permitted to return to them. The simplicity and expedition which form the distinguishing characters of this mode of trial require, that the matter to be decided should be reduced to some single and obvious point; while the litigations usually in chancery, frequently comprehend a long train of minute and independent particulars." *The Federalist*, op. cit., p. 621.

CONCLUSION

The petition for certiorari should be denied.

Respectfully submitted,

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